BANK INSPECTION

The Necessity for External Examination.

SECOND EDITION.

H. C. McLeod.

1909.

The first edition of this pamphlet was printed on 15th November, 1909, and copies were sent to the general managers of Canadian banks. A conference of bankers followed, from which a faint hope was indulged that the bankers would go on record in favor of some effective system of inspection. This hope led to withholding the pamphlet from general distribution pending action by the Canadian Bankers' Association at its meeting on November 25th, 1909. A motion that the substance of the suggested amendment to the Bank Act (see page 37) should be adopted as a recommendation to the Finance Minister, did not receive other support than to be referred to a committee quite out of sympathy with inspection from without. The pamphlet is therefore presented to legislators, to bank shareholders, and to the public generally. Facts are the best arguments, and even bankers opposed to the scheme of external inspection herein suggested admit that the arguments presented are unanswerable. I ask careful perusal, unbiased judgment, and independent action.

H. C. McLeod.

Toronto,
November 26th, 1909.

BANK INSPECTION.

ANNOUNCEMENT has been made that the Bank Act will be revised during the present session of Parliament. This, therefore, seems an opportune time to give some extended consideration to the desirability of adopting in Canada government inspection of banks, or the independent audit of banks by other means. I have long been convinced of the needfulness of independent examination, and advocated its adoption at the last decennial revision of the Bank Act. The weakest point in the Canadian banking system is the lack of any check on the direction and general management, and to this defect failures are mainly due. The government examination of the United States, and the independent audit of Great Britain and other countries, in effect investigate the conditions under which each bank is governed. The supervision of banks which is advocated is not experimental: in one form or another it is in vogue in countries transacting more than three-fourths of the business of the world.

On the 22nd of November, 1906, the *Globe* published an article over my signature urging external examination of banks.[1] That article called attention to bank failures in Canada, which were twenty-five per cent. in number within the preceding twenty-five years, while in the United States even an imperfect system of examination had reduced failures to five per cent. The article, although generally commended by the public, called forth criticism by some bankers opposed to external examination. Sir Edward Clouston in his annual

1. The letter appears in the appendix, page 27.

address, of 3rd December, 1906, to the shareholders of the Bank of Montreal said:

"During the last quarter of a century, by failures of banks "which could be organized under our present banking laws, "the loss to depositors has been under $750,000. The "noteholders, of course, have lost nothing. I speak only "of banks that could be organized under our present Acts. "Other banks during that period failed, involving loss to "both depositors and noteholders, but they were acting "under old charters, and under conditions which do not "now exist—in one case there was no double liability. "Out of the twelve banks that have suspended since 1880 "five only could obtain charters under our present system."

Of the banks in existence at the commencement of the period mentioned by Sir Edward Clouston, some were organized under Provincial charters with smaller capitalization than the Canadian Bank Act requires; some were eligible to be organized under the present Act; all were permitted to do business under the Act. A number of each kind failed, not for the reason of size, but on account of the quality of the management, which in all cases was reckless, in most cases fraudulent. If it be argued that small banks are more prone to disaster than large ones, the low percentage of failures in the United States, where the banks average very small in comparison with Canadian banks, gives increased weight to my contention. With capable management a bank of $200,000 capital is not more liable to disaster than a bank of $2,000,000 capital: the one must be content with a small circle of operation; the other must avoid the temptation to reach out with the dash and daring that in too many instances, for want of restraint, has resulted in menace and wreck. Splendid examples of banks that started with

exceedingly small beginnings may be cited from the list of active Canadian banks. Without prudent management capital is short lived: lack of prudence, which often progresses to fraud, is what external examination should disclose.

Sir Edward Clouston seemingly intimates that statistics of failures in Canada that take in the eighties are too remote. Investigating the period, 1893-1909, it is found that at the beginning there were thirty-nine banks, not under suspension, reporting to the Government; nine new banks have since commenced business, making forty-eight in all; ten have disappeared through mergers, and nine, or about nineteen per cent. of the whole, have joined the "majority," leaving at present twenty-nine banks in active operation. I say "majority" advisedly, for investigation shows that in the history of incorporated banks in British North America the list of failures exceeds in length the list of institutions active in 1909.[1] To claim that our present system has an effective restraining influence on bank management is to argue against the statistics and to urge a virtue in the Bank Act that experience shows is wanting.

In respect to the claim that less than $750,000 was lost to depositors by banks entitled to organize under the present Act, it is worthy of note that, although joint stock banking in Australia was commenced in 1816, up to the bank crisis of 1893 depositors in Australian banks had been wholly free from loss.[2] In that year the Australasian banking crisis culminated, with liabilities of suspended banks exceeding in

1. Mr. Coulson's remarks at the annual meeting of the Bank of Toronto, January 9th, 1907, are interesting. (See appendix, page 35.)

2 Mr. Cork's paper of 1894 on the crisis of 1893: "It had been the proud boast of Australians up to this crisis that no creditor of an Australian bank had ever lost by the banks."

volume the aggregate liabilities of all suspended companies and firms during any financial crisis that has ever occurred within the British Empire. I shall again refer to this crisis.

As early as 1875 the audit of banks was a subject of discussion in Canada. I quote from an article of that time: "Now, the only way in which an examination of a bank with "branches could be carried out would be by a simultaneous "audit at all points on the same day." Strangely enough, the same argument is the most prominent to-day; despite the audit of all the banks in Great Britain, in Australia, in Switzerland, in Austria and in Russia. In Germany the subject of bank audit is now under discussion. The branch banking system prevails in all those countries, some banks having more than twice as many branches as any bank in Canada. If there be any Canadian bank of which a fairly clear insight cannot be obtained by intelligent auditors within a week, by examination at the head office alone, that bank's system is out-of-date, and a chartered accountant's assistance might not be amiss for the purpose of improving it. In our investigation of the causes of failure of banks operating branches, we have not found one instance in which failure was due to bad management at the branches. The general management is always at fault, and the directors are frequently involved. There is almost no other history of the cause of bank disasters in Canada, and the same appears to be true of other countries having similar systems of banking. We have no record of fraudulent failure in which the vicious conditions existing could not have been readily detected by an expert at the head office of the bank. The assumption that a simultaneous inspection of every office is necessary to an efficient examination of a bank's condition

would therefore appear to be groundless. In fact examination of a bank's branches by auditors from without is not necessary. The correctness of this statement should appeal to to all practical inspectors; and the proposal to forestall and minimize disaster, by regular examination of the places where disaster is known to originate, should appear to the layman, as well as to the expert, to be all that is essential at present.

Before the stoppage of the City of Glasgow Bank, the Directors applied to the other Glasgow banks for assistance. After protest by the Directors against the indignity of the requirement of an examination, *a chartered accountant with only four hours' examination* was enabled to form a definite opinion, and he advised that the application be denied, as the bank was irretrievably wrecked. This examination was made at the head office. In accordance with the almost invariable rule in such cases, the business of the branches had been properly conducted and was sound. This bank had one hundred and thirty-three branches.

The article of 1875, from which the foregoing quotation is made, concludes as follows: "We shall have to trust "as heretofore to the honor of bank officials, and surely, "considering the high character enjoyed hitherto by those "in the positions of President and Cashier of our banking "institutions, the country may well rely with a great deal of "confidence on their representations." To the writer of that article the then future presented the same assurances that the present affords. But, what of the subsequent record of fabricated balance sheets and fraudulent management? We may most wisely estimate the future by the past, and on that estimate urge legislators, if not bank shareholders, to call for bank inspection from without. Since banking began, the overwhelming majority of managers and directors

have been and are entitled to the utmost confidence and the greatest respect. There have been many other managers and directors whose high social standing and seeming success have induced implicit confidence by the public, until their banks came under examination, when it was found that confidence had been abused, and that which from the outside looked like brilliant financiering was criminal recklessness. One of the features of the criminal trial of the City of Glasgow Bank Directors was the number of witnesses of highest respectability that came forward to testify to the exceptionally high standing of the parties at the bar.[1]

The Montreal *Witness* of November 3rd, 1906, published a letter by a distinguished banker, from which the following is a quotation : "It might interest the *Witness* to know that "many years ago, at the periodical renewal of the bank "charters at Ottawa, the Government had apparently pre- "pared themselves to establish this very scheme of indepen- "dent audit. The matter was introduced and elaborately "discussed by the Deputy Finance Minister, who knew "that the bankers were all opposed to it; and as proof of "its feasibility quoted from the *English Bankers' Magazine* a "report of one of the largest Australian banks doing a busi- "ness much larger than the Bank of Montreal. This report "had attached to it a certificate of its correctness by a firm "of English auditors of the usual high standing such as the "one referred to by Mr. Elmsly. It was contended that "this was proof enough of the practicability as well as the "wisdom of the practice. Unfortunately for the Minister "and his deputy, one of the bankers present happened to "pick up the *Bankers' Magazine* just quoted from, and, on "turning to the statement of the bank referred to, found on

1. Appendix, page 19, conclusion of Lord Advocate Watson's address.

"the opposite page a report of another Australasian bank—"the Bank of New Zealand—equally good in all respects to "the one quoted from, equally large, and apparently equally "satisfactory in every way.[1] It had also the usual certifi-"cate by the high class English auditors. The report was "dated only a few months back, yet the banker was able to "inform the Minister and his deputy that since the date of "the report the bank in question had confessed to the loss "of its whole reserve fund—a very large amount—and "part of its capital. The banker put down the book with "the remark: 'Comment is useless.' I think the *Witness* "may make the same remark if it looks more carefully into "the subject."

Before reaching the conclusion indicated by the dramatic incident related, it will be well to consider the cause of the crisis in Australasia, and to ascertain whether it was the result of fraudulent book-keeping or of a general decline in values following a period of inflation. For some years before the crisis, bank deposits had grown steadily and rapidly, through advertising and "touting," not only in the colonies but in Great Britain. As bank deposits increased, competition for loans became keener, in order to keep employed the rapidly increasing bank funds. This competition encouraged loans on real estate, and induced speculation and inflation generally. We are told: "The spirit of "speculation ran mad, and financiers and adventurers of "every kind had a carnival of dissipation with other people's "money." Land companies, building societies and other speculative companies were formed in considerable numbers; some closely affiliated with leading banks. Revelations of fraudulent management followed in due course, destroy-

1. The Bank of New Zealand is now in a very strong position.

ing confidence in even the old and legitimate building societies and land companies; causing a general smash of these corporations, and bringing the bank crisis of 1893 in the wake. The unwisdom of banks being permitted to virtually own or to affiliate with speculative or promoting companies, by whatever alluring name they may be called, is emphasized by this lesson from afar. A feature of the bank crisis was the comparative freedom of the banks from fraud and falsification. Nathaniel Cork, in his paper on the subject, says: "No Director or "Manager of any one of the thirteen reconstructed banks "has been charged with prostituting his bank to his indi- "vidual ends, and they are free from any taint of dishonor." Growing distrust of the weaker banks, augmented by rumors published by unscrupulous journals of the yellow type, hastened their failure, and as distrust extended to the more conservative banks a general and rapid shrinkage of values ensued, from which depression recovery has not been complete.

Bankers in decrying external examination are prone to refer to this cataclysm of 1893. A glimpse at the statistics may be instructive. Of fourteen banks that suspended in that year, thirteen were reconstructed.[1] The City of Melbourne Bank failed in 1895, the Standard Bank in 1899, and the Australian Joint Stock Bank now admits insolvency and is proposing reorganization. We may therefore count four failures out of twenty-three banks in existence at the commencement of 1893. From 1893 to 1909, with general prosperity, rapidly increasing bank deposits and advancing values, Canada shows failures of nearly one in five, while Australia, despite the long incubating causes of the panic re-

1. The Bank of VanDiemans Land failed in August, 1891, and the Mercantile Bank of Australia in March, 1892.

ferred to, with consequent shrinkage in bank deposits and in values, has a failure list which, from the statistics available at this writing, appears to be approximately one in six. We would seem to require to seek the records of some of the States of the American Union, during the wild-cat banking period of about sixty years ago, to find statistics with which our system may make favorable comparison. Whoever seeks the reason for this unfavorable result must reach the conclusion that the chief cause is want of supervision of the direction and general management of Canadian banks.

Prior to the crisis of 1893 the audit of banks in Australia seems to have been provided for in the acts of incorporation of the several banks, yet in 1896 the Government of Victoria enacted an amendment to the Companies' Act, under which the banks were operating, making an audit compulsory by auditors whose qualifications are set out in the Act. This Act is an emphatic expression of opinion of those most capable of judging of the causes of the disaster; just as the audit of banks, which became universal in Great Britain after the City of Glasgow Bank failure, was an expression of the view of British bankers on the necessity for an external audit.[1] Of course, banks in Great Britain and Australia have their departments for internal inspection, but experience in these countries has shown that an additional protection is essential, just as Canadian experience has demonstrated that fabricated balance sheets will occasionally appear so long as there is no proper supervision of the general management and of the direction. Auditing from the outside has had the same salutary effect in Great Britain, under the branch banking system, that government examination has had in the United States, where banks are not permitted to have branches.

1. The Western Bank and the Royal British Bank failed some years earlier. Both fraudulent.

Mr. B. E. Walker's statement, of the 8th January, 1907, that there are many forms of possible loss which no government inspection or audit could detect, is not an argument against external examination.[1] Those who urge such external examination do not put forth the claim that thereby bank losses will cease. The best internal regulations fail to some extent and must ever fail so long as human judgment is fallible. Mr Walker will not argue that for the reason that losses, and even irregularities, may occasionally escape the keen eye of a bank's regular inspector that inspectors are of no material service. Internal inspection is indispensable to any bank with branches, as every banker knows, notwithstanding that, in rare cases, it practically fails. The same fallibility applies to external inspection, perhaps to a somewhat greater extent, for the reason that external examination is more casual.

The trend of banking in all countries has shown that external examination is necessary, and, therefore, countries having in the aggregate about eighty per cent. of the banking power of the world have adopted external examination of banks in some form. Before the civil war, banks in the United States failed to an enormous percentage of the whole number. We cannot suppose that the devastation of that war was conducive to stability in banking, yet, forty-three years thereafter, the disasters, as pointed out in my letter to the *Globe*, averaged only five and a half per cent. according to number.[2] No person can gainsay that the improvement is mainly due to external examination adopted in 1863. At present there is probably not a banker of any standing within that country who would argue that banking there could be successfully carried on by the present system if the examination were eliminated.

1. An extract from Mr. Walker's address appears in the appendix, page 34.
2. See letter in the appendix, page 28.

Mr. Walker argues that the shareholders have the power to secure any kind of inspection or audit they want. There can hardly be a more perfect system of inspection and supervision of loans, from within, than that described in the ninth annual report of the Federal Bank of Canada.[1] Although the shareholders and the public received the assurance of the existence of an excellent system of internal examination, the system as described could have existed only in the imagination. Evidently the statement improved the credit of the bank, for at its failure the losses aggregated about seven million dollars. We need not refer to the control of the shareholders' meetings by the unworthy President of the Bank of London, nor lengthen this paper by similar references to other banks that have failed. Shareholders, outside of electing directors, take little interest in the bank of which they are proprietors; indeed they rarely take the trouble to attend the annual meetings in sufficient number to form more than a quorum. In almost all cases the directors and the management arrange beforehand the transactions of the annual meetings, and the shareholders in perfect confidence acquiesce.

Much has been written about management by directors, and in numerous cases directors have been held up in the pillory of the press for the reason that their bank had failed through the manipulations and deceptions of the general management. Lord Moncrieff, (Lord Justice-Clerk), charging the jury in the City of Glasgow case, gave a practical view of the duty of directors and one that will appeal to bankers; he said: "You have heard a good deal about what the duties "of a Director of such an institution are; and from the "views that were quoted to you by my learned friend Mr.

1. An extract from the report is given in the appendix, page 20.

"Trayner as having been expressed by the court in former "cases I have nothing to suggest in the way of dissent. A "Director is generally a man who has other avocations to "attend to. He is not a professional banker. He is not "expected to do the duty of a professional banker, as we "all know. He is a man selected from his position, from "his character, from the influence he may bring to bear "upon the welfare of the bank, and from the trust and con- "fidence which are reposed in his integrity and in his general "ability. But I need not say that it is no part of his duty to "take charge of the accounts of the bank. He is entitled "to trust the officials of the bank who are there for that "purpose, and as long as he has no reason to suspect the "integrity of the officials, it can be no matter of imputation "to him that he trusts to the statements of the officials of "the bank acting within the proper duties of the depart- "ment which has been entrusted to them. You may assume "that. It will not, however, follow from that, that where "special circumstances arise to bring under the notice of "the directors particular interests connected with the joint "stock company there may not ensue an obligation of "inquiry and an obligation of action which might not be "necessarily inferred from the nature of the position which "they hold. We must look this matter plainly in the face "as it actually occurs in practical life. Remark has been "made on the amounts — the extraordinary amounts — dis- "closed in this case — amounts that take one's breath away "as applied to ordinary commercial concerns; but we must "not assume that in the inception of the sad history which "we have had detailed here during the last fortnight there "was anything abnormal whatever."

Whatever may be said of the privileges and the duties of

directors, the fact remains that too frequently the general management of banks falls into the hands of the incompetent and unworthy. In cases where the directors are not involved they generally seek to do their duty; sometimes to find after many years that they have been systematically deceived. All, or practically all, of the directors of the Ontario Bank, although they gave what they thought to be the most careful attention to the bank's affairs, remained perfectly satisfied and proud of the solidity of their bank, until within a few weeks of the closing of its doors.

Viewing the development along the lines of safety of commercial banking in other countries, which has been shown to be greatly aided by external examination, surprise may be expressed that with a few exceptions the general managers of banks in Canada are opposed to the adoption of any of the systems of examination in vogue elsewhere. But the banks of Canada are more than commercial banks. In their much advertised capacity of savings banks they absorb a great portion of the floating wealth of the country. Much of the savings of the thrifty that are thus acquired comes from depositors not in a position to judge, or incapable of judging, of the quality of the management of the bank selected as a depository. Mr. Walker's claim, that it is not difficult to estimate the quality of the management of a bank, is correct, when applied to the facilities that a general manager may have of judging of a competitor, but depositors as a rule have not the technical knowledge necessary to a correct judgment. In this respect the depositor of small means should be safeguarded. Another feature that entitles the savings depositor to consideration in banking legislation, is the fact that he is merely a general creditor of the bank in which his savings are placed. Noteholders are protected by

the conditions of the law which make a bank's notes the first claim on its assets; the government is protected in that its claims come next; the savings depositor falls into the last class, that of the ordinary creditor who is paid only after the noteholder and the government. It seems only fair and reasonable that a class of creditors so little able as a rule, to afford the loss or even the temporary withholding of their small savings, and so little able to judge of the quality of the institutions in which their savings are lodged, should have the protection that may be afforded by external examination. The following extract from the report of 1907 of Mr. Pierre Jay, Bank Commissioner of the State of Massachusetts, is a clear statement of the manner in which the necessity for protecting the savings depositor is generally recognized in other countries:

"The savings of those of small means, both in the "United States and in foreign countries, have always been "regarded as entitled to exceptional protection. Laws have "been enacted carefully regulating the loans and securities "in which savings may be invested by the agencies author-"ized to receive them. The Massachusetts savings bank "laws have served as the models for those of many other "States, and the system of savings banks which has grown "up under them is one of the great achievements of the "Commonwealth.

"The Governor in his inaugural address wisely recom-"mended that the investment of savings deposits should be "uniform in all institutions authorized by the Common-"wealth to receive such deposits; in order that, whether he "puts his savings in savings banks or foreign banking cor-"porations or trust companies, the savings depositor may "know that they are invested in the same kind of loans and "securities, and are equally safe."

In Canada, as we have already shown, instead of receiving protection, savings depositors are entitled to rank on the residue of a bank's assets only as general creditors. Depositors, large and small, have been placing their savings in Canadian banks since banking began in this country. In former years the volume of deposits was moderate, but during the past twelve years there has been an enormous expansion in the totals. Most banks have dealt with these savings in a legitimate way. We know that in some banks that have failed, money has been dumped by the general management by hundreds of thousands of dollars, and even millions of dollars, into speculation or into promotion schemes. It is true that in recent years depositors have not suffered by the larger failures. This is not due to any protection thrown over them by legislation, but to the self-preserving action of bankers, combining to avoid the disturbance of credit and the distress that would be caused by suspension and ordinary liquidation. One unfortunate result of such combinations of banks is the idea that has gone abroad among depositors that deposits now are as safe in one bank as in another; an idea that is likely to be distressfully dissipated when the next bank wreck occurs.

From the arguments presented herein, it is apparent that the want of stability in our banks is not due to conditions appertaining to the business of the country. These conditions have been such as should insure success of banking institutions operating under any financial system entitled to exist unchanged. Despite favoring conditions bank disasters have been of more frequent occurrence here than elsewhere, due in most, if not in all cases to causes removable by external supervision. We have seen that inspection from within is useless to prevent the failures that arise from the

fraudulence of the general management, in which the directors often share. Where the directors perform their duty they are often deceived by the misrepresentations of the management. The directors and the general management of corporations of all kinds are accustomed to control the voting power at the regular shareholders' meetings: therefore, the suggestion that shareholders may have any audit they want is not a remedy that would be applied generally and effectively. The only reasonable conclusion, in regard to means to be adopted for the prevention of bank failure, is that the remedy must be by verification of the work of the general management. That remedy can be applied at the head office, where the evidence is available on which the general management prepares the statements furnished to the public. The custom of auditors and examiners of a bank having branches is to examine the inspection reports made by the bank's regular inspectors, as well as to pay special attention to the accounts from any branch having transactions out of the ordinary, in magnitude or otherwise. We have shown that these methods are practised in other countries having a branch banking system, as well as in countries where the branch banking system does not prevail, and that the results are salutary.

In presenting this subject I have thought it well to reproduce, in the form of an appendix, pertinent articles that have appeared in the press, including those articles that present the most potent arguments against examination of banks from without, my desire being to give the reader the opportunity of readily reaching a judgment on this matter, which has such a vital connection with the financial and commercial prosperity of the country.

APPENDIX.

City of Glasgow Bank Criminal Trial of General Manager and Directors.

Conclusion of the address by the Prosecuting Attorney, Lord Advocate Watson:

Gentlemen, I have only one word to say in conclusion, and I regret that that word should have been forced upon me by the enormous mass we have had in the present case of evidence of character. I don't ask you to lay aside for one moment the fact that these were gentlemen of position and of high repute. They are entitled to any fair presumption arising from their having such repute; but to press that evidence to the length to which it has been pressed by witness after witness in that box, is the most preposterous thing I have ever heard in a Court of justice. If it be true that not one of them is capable of committing such an offence, nobody did it — a very singular result. Evidence of character in connection with certain offences is a valuable ingredient in determining the guilt or innocence of the accused; but I tell you, in a charge of this sort evidence of character — although it is not to be laid aside — means that you are not to treat them as if they were men of bad character; it amounts to no more; I tell you that an offence such as this is impossible except to a man of good character. If a man has not a good repute — if a man has a bad repute — you will never find him in the position of a Director of a great bank, entrusted with millions by the public, or in a position to work that wreck upon any institution which has befallen the City of Glasgow Bank.

September 12, 1879: *Montreal Star* states:

Sir Francis Hincks is reported to have said: "If anyone believes "that a bank manager cannot keep the true state of affairs from the "directors that man knows nothing of banking."

NOTE:—Sir Francis Hincks was formerly Minister of Finance of Canada. Unfortunately for him he was President of the City Bank, Montreal, which merged with the Royal Canadian Bank into the Consolidated Bank of which Sir Francis became President. Doubtless each of the merged banks was insolvent at the time of the amalgamation, May 1876. The new bank lasted about three years, the end being disastrous to all concerned; disclosing the usual features of bank wreckage.

Directors' Assurances of Supervision Federal Bank of Canada.

Extract from President's address at the 9th annual meeting, June 19th, 1883:

When you consider that before any credits are granted they are carefully discussed by the Board; when you consider every application for credit or discount is first transmitted by the local manager accompanied by a full report as to the customers' business, character and means, that weekly, monthly and quarterly statements are received at the head office, carefully examined by the general manager, inspector and assistants, as also by the board, you will agree that the system and supervision cannot be well improved and that losses are thereby, if not avoided, at all events, reduced to a minimum.

Improve Bank Inspection.

Extract from letter of "Trustee" to *Monetary Times*, October 22, 1906, Page 602, Vol. 40:

A bank inspector is seldom, if ever, a skilled accountant. He is, I understand, never appointed by the shareholders but always by the directors, or by the manager himself, and is supposed not infrequently to be a special favorite of his manager.

If this be so, how can there be a really independent and impartial investigation by such an inspector?

Whether a body of government inspectors should be appointed, or whether independent skilled professional accountants should be employed, I am satisfied that, if as rigid investigations were conducted regularly into the affairs of our banks, as are now conducted into the affairs of our mortgage loan companies, such disastrous failures (for the shareholders) as that of the ill-fated Ontario Bank, could not occur.

Extract from article, "Direction, Detection," *Monetary Times*, October 27, 1906, Page 597, Vol. 40:

The main check on the general manager is the active interest taken in the bank's affairs by the directors. Of Canadian directors as a whole, Mr. Eckhardt writes in liberal praise, and specially commends their "full attendance at the semi-weekly board meetings."

Bank Inspection.

Copy of letter by Mr. Thomas Fyshe which appeared in the Montreal *Witness* of October 29, 1906:

To the Editor of the *Witness*: Sir,—I regret to see from your re-

cent issues that you are taking a stand in favor of government bank inspection, apparently impelled thereto by the recent shameful collapse of the Ontario Bank. This proposition has been under discussion at every renewal of the bank charters, extending back for over thirty years, with the result that the opinion of the bankers is almost unanimously opposed to it. It is a simple matter of fact, that the legislation on which our admirable banking system is founded, was the work almost entirely of the bankers, who have had many strenuous fights with the politicians to prevent the introduction into Canada of American banking ideas, which would have been fatal to our system and disastrous to the country. The Americans are to-day cursed with a banking and currency system which is a disgrace to them, and which the united wisdom of the country seems unable to cope with. If we had been guided by our politicians we should probably have reached a similar situation. On the contrary, our bankers convinced the politicians that so far as banking was concerned they knew better than the Yankees, with the result that we now have a banking system second to none in existence, the advantages of which to the nation are everywhere conspicuous. Owing as much as they do to the bankers of the country for this great service, it is to be hoped that the people of Canada, before tinkering with the Bank Act, with the view of establishing government inspection, will take counsel with our bankers, and be guided by their judgment, as being a matter which they thoroughly understand, and which the public do not.

It has become too much the habit to appeal to the government to regulate everything that goes wrong, forgetting the tremendous seriousness and significance of making a new law which may work a hundred times more mischief than it is designed to remedy.

Better, perhaps, to bear the ills we have than fly to others which are not unlikely to be worse — even at the suggestion of such a respected organ of public opinion as the *Witness*.

There is this other view of the case: Why should any great public effort be made to maintain in existence such institutions as the Ontario Bank has shown itself to be? No government inspection could ever have changed it, or made it worthy of living.

Such institutions are destined by their very nature to be crushed out sooner or later, and the sooner the better.

If, instead of thinking of establishing government inspection with the view of bolstering up weak institutions, which have little warrant for existing at all, the government would seriously consider the unwisdom of continually chartering new banks as they are applied for, by people with more ambition than sense, they would confer a much more substantial benefit on the country, by refusing to create institutions which the country does not need, and which when created, are likely in time to go the way of the Ontario Bank.

70 McTavish street, Oct. 26, 1906. THOS. FYSHE.

Bank Inspection.

Copy of article in Montreal *Witness*, October 29, 1906:

Mr. Thomas Fyshe, the distinguished banker, in his letter to the *Witness* to-day, deprecates government bank inspection. Mr. Fyshe, however, offers no help in the present crisis. What the public is principally concerned about is that something should be done, and as early as possible, to prevent a recurrence of such a disaster as that of the Ontario Bank. For years that bank has been rotten and its notes illegal, and yet the Bankers' Association did not know anything about it. Neither did its own directors. So soon, however, as the books of the head office came under examination surprising frauds were obvious. The position that the *Witness* takes is that if the Ontario Bank's affairs had been independently audited the bank could not have got into such a deplorable condition, or, at worst, would have been put out of business long ago. Whether the inspection should be done by the government or by the Bankers' Association is a question open to discussion. An independent audit of some kind is evidently needed and should in each case be demanded by shareholders. Professional accountants, acting on behalf of the Finance Department and the shareholders is the method favored in some quarters. No one could think of asking for the unelastic banking system of the United States. There may be special auditing difficulties as the result of our extensive branch system, but a head office audit would, so far as appears, cover the public need. The banks themselves look pretty well after the branches. The failure of the Bank of Yarmouth, last year, and the present Ontario Bank fiasco are sufficient proof of the necessity for reforms. Mr. Fyshe himself says:

"It has become too much the habit to appeal to the government to "regulate everything that goes wrong, forgetting the tremendous "seriousness and significance of making a new law which may work a "hundred times more mischief than it is designed to remedy.

"Better, perhaps, to bear the ills we have than fly to others which "are not unlikely to be worse—even at the suggestion of such a re- "spected organ of public opinion as the *Witness*.

"There is this other view of the case: Why should any great public "effort be made to maintain in existence such institutions as the "Ontario Bank has shown itself to be. No government inspection "could ever have changed it, or made it worthy of living.

"Such institutions are destined by their very nature to be crushed "out sooner or later, and the sooner the better."

Such inspection as we advocate would surely have resulted in something better and not worse than the present state of things. It would indeed have resulted in the closing of that institution long ago, which,

to all outward appearance, was so flourishing right up to the last annual meeting (when the dividend was increased), and for some time afterwards. Take one point: The bank had illegally bought up its own shares, so as to bolster up the market and give the shares bought and sold by the public a fictitious value. We agree with Mr. Fyshe in his view that the sooner such a calamity-carrying piece of deceit is put an end to the better. It appears to us that it is for our bankers now to suggest what safeguards will guard our banks against the popular suspicion which is liable to grow out of such revelations and in times of excitement fall upon the just as well as the unjust.

Against Shareholders' Auditing.

Extract from letter by "Accountant" to *Monetary Times*, dated October 31, 1906, Page 668, Vol. 40:

Why cannot the boards of directors of banking institutions appoint one of themselves, an expert in this line, as supervisor of inspectors, with a title commensurate with the dignity and authority of the position, to report to the board in the same way as the railway 4th vice-president? Their doing so will give them protection against themselves and against excessive authority and fraud on the part of their general manager or loss through their agencies. Government inspection is necessary for the protection of depositors and I suppose the reason it did not protect the Ontario Bank will be found to be inadequate personal inspection; but the directors and shareholders have the means and should take steps to protect themselves independently.

ACCOUNTANT.

The Independent Audit.

Copy of letter by Mr. Thos. Fyshe which appeared in the Montreal *Witness* of November 3, 1906:

To the Editor of the *Witness*: Sir, — If the *Witness* desires to retain its reputation for good judgment and serious purpose, I think it should be a little more careful about its action in recommending so confidently what it calls the 'independent audit' as the 'cure all' against bank failures.

In to-day's issue it quotes Mr. A. F. C. Ross as saying: "In my "opinion an independent audit would be the best possible safeguard a "bank could get." It also quotes Mr. Black, another accountant, as saying that "as a principle (whatever that may mean) an independent audit would be a very good thing." It also refers its readers to a letter

from Mr. Elmsly, of the Bank of British North America, which states that that bank "has always had one of the most reputable firms of "chartered accountants in London to audit the accounts of the bank." What is likely to be the good of an audit of accounts in London prepared under the supervision of its general manager and managers, scattered from Montreal and New York to San Francisco and Dawson City? And is an audit of accounts all that is wanted? Bankers know that what is necessary to secure certainty is an audit of the facts or valuation of the assets, which is a very different thing.

Then, what are we to think of the weight to be attached to the *Witness's* urgent recommendation of a new law, based on the statements of two accountants, that it would be a good thing for the country? It would certainly be a good thing for the accountants, but this is hardly conclusive. The bankers, I presume, should not be consulted, for, although they know more about the matter than anybody else, still they are the parties the public must be protected against. Because a bank fails occasionally and discloses rascality on the part of its manager, is it reasonable to make a new law to provide against all bankers being rascals?

It is surely worth considering first whether the game would be worth the candle, even if you could attain the object.

What forecast has the *Witness* made in its own mind of the probable working of this new institution it so highly recommends, after it has been in existence for a few years, and has got thoroughly accommodated to the mechanical, slipshod and perfunctory methods of government officialdom?

It might interest the *Witness* to know that many years ago, at the periodical renewal of the bank charters at Ottawa, the government had apparently prepared themselves to establish this very scheme of independent audit. The matter was introduced and elaborately discussed by the Deputy Finance Minister, who knew that the bankers were all opposed to it; and as proof of its feasibility quoted from the *English Bankers' Magazine* a report of one of the large Australian banks doing a business much larger than the Bank of Montreal. This report had attached to it a certificate of its correctness by a firm of English auditors of the usual high standing, such as the one referred to by Mr. Elmsly. It was contended that this was proof enough of the practicability as well as of the wisdom of the practice. Unfortunately for the minister and his deputy, one of the bankers present happened to pick up the *Bankers' Magazine* just quoted from, and, on turning to the statement of the bank referred to, found on the opposite page a report of another Australian bank — the Bank of New Zealand — equally good in all respects to the one quoted from, equally large, and apparently equally satisfactory in every way. It had also the usual certificate by

the high class English auditors. The report was dated only a few months back, yet the banker was able to inform the minister and his deputy that since the date of the report the bank in question had confessed to the loss of its whole reserve fund — a very large amount — and part of its capital. The banker put down the book with the remark: "Comment is useless." I think the *Witness* may make the same remark if it looks more carefully into the subject.

The *Witness* thinks to strengthen its case by instancing our system of insurance inspection, of the value of which it seems to have a high opinion. The state of things disclosed by the present insurance investigation is a scandal to the country. There is hardly a company, unless there be one in the west, that has reaped anything but discredit from it, while some have reaped deep disgrace. Yet for a great many years there has been in this country a system of rigid government inspection, based on the insurance law, with its strict limitations as to investments, etc.

Contrast this state of things with that which exists in the Old Country, where their life insurance companies are as conspicuous for their merits as ours are for their demerits, notwithstanding that the English law virtually gives them carte blanche as to their investments, and requires only that they be given full publicity.

A better argument than this could hardly be found against the *Witness's* position.

November 1, 1906.

THOS. FYSHE.

Copy of article in Montreal *Witness* of November 3, 1906:

Mr. Fyshe, the distinguished banker, is mistaken in thinking that the *Witness* recommends the independent auditing of banks as a 'cure-all.' We have been careful to say that it was not. It might not save everything or everybody, but would surely prevent, for instance, such a scandal as that of the Ontario Bank, even if the bank had had to be closed up or go under sooner or later. Mr. Fyshe says that government inspection did not prevent the insurance companies from doing those things they ought not to have done. While there is some truth in that, it is a fact that everything brought out in public was found in the note-books of the insurance department, that the audit was honest, precise and careful, and that every management in the country acted with it continually before its eyes, and that even investments which managements had thought wise were withdrawn and reinvested upon the department's representation. However, the whole insurance case will come up for discussion when the commission makes its report, and, perhaps, earlier, if that is long delayed. In the meantime, does

Mr. Fyshe think that bank managements would come out any better if the way they had invested the public's money . . . the past few decades were similarily probed? Would he recommend such an investigation instead of an independent audit?

Bank Audits and Inspection.

Extract from article in *Monetary Times*, November 3, 1906, Page 634, Vol. 40:

The employment of independent chartered accountants as auditors did not prevent the suspension of hundreds of Australian banks in 1893.* The employment of an independent auditor would surely have prevented the Ontario Bank fiasco. The trouble at the Ontario Bank was not in lack of government inspection, but, apparently in lack of inspection altogether at the head office. The Ontario Bank seems to have been quite an exception in that regard. Its general manager had no experience in a head office before he took the reins. No other general manager of a Canadian bank would be able to raise in New York, on his own word, more money than would obviously be necessary for his current personal expenditure while on the business of the bank, without a voucher signed by two officers of the institution.

*Sixteen banks suspended in 1891, 1892 and 1893, of which three failed in that time.

What the Bankers Think.

Extract from article in *Monetary Times*, November 10, 1906, Page 669, Vol. 40:

The general view among Canadian bankers continues to be that government inspection is not desirable; would not achieve thorough knowledge of a bank's affairs, and might indeed be harmful because giving the public an impression of governmental guarantee, while the officials from Ottawa know no more than any other inspector would or could.

There is one among the general managers of banks who approves of government inspection, but probably he stands alone.

Inspection of the banks by government officials must be simultaneous to be effective. *If not done all at the same time they would inevitably "get out of one another's way," that is to say one bank might—supposing it to be in difficulties—arrange for assistance from another friendly bank which had already been inspected.* (The italics are ours.)

Appoint Two General Managers.

Extract from letter by "Banker" to *Monetary Times*, November 17, 1906, Page 717, Vol. 40:

As a careful reader of your paper for many years, permit me to express briefly my views upon the question of bank inspection. Some writers favor an independent audit; others inspection y Government officers. Either could readily be made at the head office of any bank, and be efficient, so far as mere figures are concerned. Bank bookkeeping is very simple and easily understood by any competent accountant. Inspections of branches would be unnecessary as it is invariably at the head office that "crooked work" is done, branches being well inspected by the banks themselves. But neither an auditor nor a Government inspector could possibly express a valuable opinion upon the assets covered by the balance sheet of any bank. Only an officer of the bank itself could do that, and he would have to be experienced and trustworthy.

Inspections of any kind would not prevent wrongdoing, they would merely disclose it, and that not always.

The question is to find the party guilty of such, and if possible apply a remedy.

A recent correspondent of yours put his finger on the spot when he said: "Under our present system the general manager has become the king of the institution. He is in a position to hoodwink the board of directors, and no other official of the company dare say a word to them as to the conduct of its affairs, no matter how bad he might know them to be."

Call for an Independent Inspection of Banks.

Copy of letter by Mr. H. C. McLeod, General Manager of the Bank of Nova Scotia, which appeared in the Toronto *Globe* of November 22, 1906:

To the Editor of *The Globe*: Through the press and from the platform the banking system of Canada is lauded as being the best in the world. In many particulars the system is admirable, our elastic bank currency and the readiness with which the banking requirements of new districts are met by branch extension being its strongest features. However, it is not without defects, some of them of vital importance. Of these the most prominent is the lack of external inspection, which experience in the western hemisphere has demonstrated to be essential. The public have been reminded of this necessity by the recent failure of the Ontario Bank and the leading papers of the country are

almost a unit in demanding reform in this particular. The reasonableness of this demand is made clear by a review of Canadian banking history since 1880 and before, and is confirmed by the experiences of our near neighbors prior to the civil war. In 1880 there were in existence in Canada forty-one banks; since then seven have been incorporated and have commenced business, making a total of forty-eight banks. Of this total twelve have failed and some others have saved themselves by amalgamation. The failures are, therefore, twenty-five per cent. within a period of twenty-six years, the last ten of which were years of unexampled prosperity, with steadily rising deposits, conditions under which even insolvent banks seldom close their doors. Most, if not all, of the above mentioned failures were fraudulent, and it is now plainly evident that a few hours' examination by a skilled banker would have disclosed an insolvent condition in any one of the banks, years before it collapsed. In each of the two most recent disasters a correct diagnosis could have been made ten or more years ago. Some urge that the Government should call for special returns, but what value should attach to special returns from the Bank of Yarmouth, from the Ontario Bank, or from any of the other wrecks gone before? They would simply have enlarged the piles of incorrect and deceptive bank returns in the Finance Department. What is written by one having unusual facilities for observation is eminently true: "It is extremely rare to find a bank has failed without some of the officers committing fraudulent or illegal acts to hide it." There is at least sufficient truth in the above to dispose of the suggestion of special returns and to dispel faith in the returns of badly managed banks.

Some Canadian bankers, including one writer, whose words are entitled to great weight, contend that Government inspection has failed in the United States. Under the National Bank Act of that country there has been a somewhat imperfect system of bank examination, and a more imperfect system by some of the State Bank Departments. I say imperfect, for under the national system there were employed last year 78 examiners, whose duties required the making of no less than 11 516 inspections each year! For the forty-three years during which the National Bank Act has been in operation there have been established 7,966 banks. Of these 460 have failed, the failures being equal to 5½ per cent. of the whole number for the period. As for the banks other than national, with a more imperfect system of inspection, or no system at all, the failures reached 17½ per cent. The comparison of the percentages appears as follows:

National banks failed in 43 years	5½ per cent.
Other U. S. Banks failed in 43 years	17½ per cent.
Canadian banks failed in 26 years	25 per cent.
National banks failed in 26 years (same period) .	5 per cent.

External inspection must not be regarded as an unfailing cure; i'

has its limitations, and the best that can be said of it is that it is a preventative that, if properly applied, will make bank failure almost unknown. An inspector cannot discover an embezzlement until after the act is committed; neither can he avoid a ruinously bad debt made before his visit, but the progress toward failure is generally slow and in the majority of cases a prudent inspector would, by his advice and authority, save the situation and direct the management into safe channels.

The subject of the establishment of an effective bureau of inspection is one of the utmost importance, for unless it is founded on conservative lines, in which the interests of all sound institutions are carefully conserved, much more harm than benefit would ensue. Bank shareholders are the parties with the major interest at stake, and for the present the subject would be better if left to them and to their representatives, in the hope that a satisfactory solution of the problem may be reached.

Toronto, November 21, 1906. H. C. McLEOD.

Bank Inspection from Within.

Copy of an article which appeared in *The Globe* of November 28, 1906:

About three weeks ago *The Globe* threw out the suggestion that, whatever might be the merits or efficiency of Government inspection of the transactions of a chartered bank, it might be a good thing to have an officer appointed by the Board of Directors, who would be independent of the General Manager, and whose duty it would be to inspect, in the fullest sense of that term, the head office as well as any branches he might choose to visit. One suggestion included the idea that this official, howsoever entitled, should report to the Directors, not to the Manager, and that he should inform the Board of the dealings of the directors individually with the bank. Such reports as a competent official, armed with such inquisitorial authority could make to his Board might be of great advantage to the bank, because they would be the best practicable guarantee to the depositing and note-holding public that no questionable transactions were tolerated in the institution.

It is interesting to learn, from a report in another column, that the directors of the Traders' Bank of Canada have taken a new departure in the line of the above suggestion, and have actually appointed a Directors' Auditor and President's Assistant. While this is the first formal appointment to the position so designated, it appears from the published statement that the system described has already been tried by the Traders' Bank with satisfactory results. It would not be surprising to find the precedent thus set followed by other banks, to the general advantage of the whole community.

Bank Inspection from Within.

Copy of letter by Mr. McLeod which appeared in *The Globe* of November 29, 1906:

To the Editor of *The Globe*: With reference to a leading article in your issue of to-day under the above caption, I most respectfully beg to ask what benefit would have accrued from an inspection by an employee of the bank and a special representative of the Board of Directors in any of the following mentioned failures:—The Exchange Bank of Canada the Maritime Bank of Canada, the Bank of London, the Central Bank of Canada, the Federal Bank of Canada Commercial Bank of Manitoba, Banque Ville Marie, the Bank of Yarmouth, or indeed of almost any other bank that has failed, omitting the Ontario Bank, the facts of which failure are now the subject of inquiry by the courts?

From the history of bank disaster, it appears that, while there are exceptions, the rule is that at least the directors dominating have knowledge of, or are directly concerned in, the failure of their bank, and often they are the cause of the disaster. The remedy is external inspection, and that remedy was applied in Scotland after the failure of the City of Glasgow Bank in 1878. There, in each case, chartered accountants are appointed to audit the bank and to verify its statements. The same plan is in vogue throughout the United Kingdom.

Toronto, November 28, 1906. H. C. McLEOD.

More About Bank Inspection.

Copy of an article which appeared in *The Globe* of November 29, 1906:

Mr. H. C. McLeod, General Manager of the Bank of Nova Scotia, discounts the suggestion that a useful purpose would be served by a special official on the staff of a bank whose duties are confidentially inquisitorial, whose standing is not subject to the approval of the General Manager, and whose services are at the call of the President, or of the Board of Directors, or of any individual member of the directorate. He cites instances in which such an officer would be handicapped because, he says, "The rule is that at least the directors dominating have knowledge of, or are directly concerned in, the failure of their bank, and often they are the cause of the disaster." Granted that dishonest "directors dominating" would be able to dismiss or circumvent any of their employees. What is contemplated in the appointment of such an official is that the directors are honest as well as capable, and are desirous of obtaining all useful information concerning

the operations of their bank. Assuming that the Directors are dishonest and the General Manager dishonest, not only could the bank's own inspection be defeated, but even "external inspection" might be deceived. In any case "inspection from within" is a protection provided by the bank itself, its shareholders, or its directors, while "external inspection" is a matter for the Government, or the Bankers' Association, or some other outside interest. The one does not exclude the other.

Outside Bank Inspection.

Copy of letter by Mr. Thomas Fyshe which appeared in the Montreal *Witness* of December 1, 1906:

To the Editor of the *Witness*: Sir, — Allow me to congratulate you on having found among the bankers a supporter of your proposal to establish a system of outside bank inspection. I am afraid, however, that it will take more than all the assistance you can get both from Mr. McLeod and your correspondent, 'Observer,' to make out a good case for the establishment of any such foolish machinery.

You say, 'An effective bureau of inspection would have saved the Banque du People, the Banque Ville Marie, the Ontario Bank and others from their worst evils, even if it did not save them altogether.'

Setting aside the necessary definition of your phrase, 'an effective bureau of inspection,' and supposing such a thing were obtainable, in my opinion it could not have done any such work as you claim. It is hardly possible to conceive of such results being brought about by any possible audit or inspection

What manager or director in control of any of our banks would be content to be taken charge of, like so many stupid, errant schoolboys, and twisted or guided or bullied into a condition of fitness, by irresponsible auditors or inspectors, carrying probably less weight than some of their own clerks?

You talk of 'inspection,' but what you evidently have in mind is some kind of regenerating apparatus for achieving a combination of moral and mental reform, rounded out and completed with a special banking training by means of which unprincipled and incompetent bank managers and directors can be transformed into efficient specimens of their kind; and the institutions they are connected with so saved.

But if it had been possible for an effective bureau of inspection to save the banks named from failing, would it have been a good thing for the community? I say, most emphatically, no. Death is as necessary in this world as life, and, when efficiency has gone out of an institution, in God's name let it die. Its place will be taken by something better. What the community wants is efficiency; and it can have that

only from the powerful institutions, owing their strength to spontaneous growth from within, not to buttressing up and watching care from the outside.

Nature's way of working is to obtain strength and efficiency by establishing a struggle for life, and causing the fittest, because the strongest, to survive. The *Witness* and its supporters know better. They say — let all live, good and bad, strong and weak alike, and let the community establish machinery to take charge of the incompetent and bad, and reform them, and make them competent so that they may continue to hold their position, and the weak institutions with which they are connected be kept alive, and things made pleasant all round — and damn the expense!

But Nature will have none of it. Strength will continue to rule till the end of time; and we shall only waste our time and energy and money by trying to make the virtually dead or dying to live.

The world is already suffering to a deplorable extent from its ever-growing army of non-producers, but the *Witness* still calls for more.

The *Witness*, I am glad to see, has a high opinion of the Bank of Nova Scotia. It is probably, for its size, the strongest bank in the country, and it deserves all the credit that it has, both for the work it has done, the position it has achieved, and for the men it has raised. But it might interest the *Witness* to know that, thirty-five years ago, that bank had an experience not unlike that of the 'Ontario,' of recent date. Its manager took to speculating to an enormous extent with the bank's money, on his own account, and caused such loss to the bank as to endanger its credit and existence. Fortunately, however, there was then, as now, no government, or outside inspection to enable the carping press and gaping public to get in their fine work; otherwise, the bank, instead of living to be a blessing to the country and a credit to all connected with it, would in all probability, have been speedily hurried to a dishonored grave. As an example in this discussion it is well worth pondering over.

THOS. FYSHE.

70 McTavish street, November 27, 1906.

Bank Inspection.

Extract from letter by the Vice-President of the Institute of Chartered Accountants of Ontario, *Mail and Empire* December 1, 1906:

The failure of the Ontario Bank has drawn special attention to the point in bank administration at which there is no watchdog — the general ledger at the head office. Here is the reservoir into which pour the streams of statements from the inspected branches, and from this source are drawn the facts and figures that present the bank's condition monthly to the Government and half-yearly to the shareholders.

Outside and independent inspection and thorough audit is possible here, and it should be instituted forthwith in the interest of the public and the shareholders, and for the preservation of the deservedly high reputation that Canadian banks have achieved. The president of the Ontario Bank certified that the Bank's statements to the Government and shareholders were true; the other presidents do the same thing. Does anyone believe that presidents know of their own knowledge, reached by personal checking and inspection, that the figures presented are even approximately correct? Let us continue to have the signature of the general manager to a bank's statement, he ought to know, he is paid for knowing, and should be held to grim responsibility, but let us also have the verification by independent, competent accountants, wholly free from the influence of the general manager and the directors, that the statements presented are true abstracts from the bank's ledger at the head office and actually represent its financial condition at the date of issue.

A former president of a Canadian bank, an eminent statesman, one who had been Finance Minister of Canada, I refer to the late Sir Francis Hincks, was arrested on a charge similar to that made against the president of the Ontario Bank. The prosecution failed because Sir Francis could not, any more than could Mr. Cockburn, be certain that what he signed was true, but the law (very absurdly, I think) made his signature obligatory.

J. W. JOHNSON, F. C. A.

Belleville, November 9, 1906.

The Eastern Townships Bank.

Extract from Directors' Report presented at the annual meeting, December 5, 1906, *Monetary Times*, Page 884, Vol. 40:

The wrecking of the Ontario Bank is one of the unfortunate incidents of the year. That the failure of such a large institution did not cause any disturbance in financial circles, and that its creditors were not seriously inconvenienced is a matter of congratulation. It has, however, again raised the question of Government or independent inspection, and the matter is now under consideration by the Bankers' Association and the Finance Department of the Government. Your board would favor any well-devised system which will safeguard the interest of the shareholders and the public.

Bank of Ottawa.

Extract from President's reference to the failure of the Ontario Bank in his address at annual meeting held December 12, 1906, *Monetary Times*, Page 924, Vol. 40:

This incident has evidently originated some suggestions which have

appeared in print demanding a better safeguard of the interests of stockholders by improved methods in the performance of the several duties of bank directors and officers.

The Molsons Bank.

Extract from article in *Monetary Times*, December 15, 1906, Page 871, Vol. 40:

Mr. Elliott, General Manager of the Molsons Bank, has joined Mr. McLeod, of the Bank of Nova Scotia, in the advocacy of outside inspection. But there is no reason to think that there is more than an influential, though numerically weak, minority in favor of this radical departure, which would only weaken responsibility where it should be strengthened.

Canadian Bank of Commerce.

Extract from Mr. B. E. Walker's reference to the failure of the Ontario Bank in his address to shareholders at annual meeting, January 8, 1907, *Monetary Times*, Page 1049, Vol. 40:

Neither Government inspection nor compulsory audit can do for us what our trained bankers do. Still if Government inspection or compulsory audit would give any substantial protection to the general public we would not object. These systems, however, must more or less create the impression that they afford a protection which they cannot in the nature of things possibly afford. We do not mean to say that such an examination would not have discovered some of the deceit recently laid bare in the bank referred to, but we do say that there are many forms of possible loss to shareholders which no Government inspection or audit by a chartered accountant could detect.

In the last analysis a bank must be judged by its board and by the men who constitute its management, not merely at head office, but at its branches, and it is not so difficult as some would have us think to judge whether a bank is carefully officered and safely managed or not.

We need not expect that bank officers can be made wise or honest by legislation, nor can any Legislature successfully protect innocent people from the effects of their own bad judgment and lack of business skill in selecting their investments. Besides, it is to be borne in mind that the shareholders of any bank have sufficient power, without further legislation to secure any kind of inspection or audit they may desire.

Bank of Toronto.

Extract from General Manager's Address at the fifty-first annual meeting held January 9, 1907, Page 1051, Vol. 40 :

Looking back over the period of fifty years, we are reminded of the changes that have taken place in the banking institutions of the country. We are prepared to find changes in a business community amongst the ordinary mercantile houses, but in connection with financial institutions, we are apt to consider it natural for them to exhibit greater stability. The record of the past, however, does not show that this is a necessary result.

When the Bank of Toronto opened its doors in 1856 there were twelve chartered banks in the Province of Ontario and Quebec. Of these there are only five doing business to-day. In the next succeeding ten years thirteen new banks were formed ; of these five are left. In all twenty-two banks in these two Provinces have gone out of existence since we began to do business. Including those mentioned, eighty banks have opened for business in various parts of the Dominion, and of these only thirty-six now remain, the others having passed out of existence, either by suspensions, liquidation, or having been absorbed by some of the remaining banks.

On Their Deliverance.

Extracts from article in *Monetary Times*, February 7, 1907, Page 1223, Vol. 40 :

"We were told we had earned a very large dividend. The bank as "a matter of fact so far as its branches were concerned, with its mil- "lions of discount business, was in first-class condition, but from being "a bank it was turned into a bucket-shop." — Ex-President Cockburn of the Ontario Bank.

I never was more sure of anything in my life than "that the bank was in a very good condition." — Hon. Richard Harcourt, ex-director Ontario Bank.

The Ontario Bank collapse contains warnings enough for everybody. Like every other monitory event it produces teachings that are apt to be distorted. The lesson here is that of ordinary efficiency of business control ; and not a call for outside officiousness. If you have incompetents in command any amount of Government inspection will not remedy the affliction. It will only supply a crutch to weakness when weakness needs a spur. And so, let us await the dividend to Ontario Bank shareholders,[1] and trust for a merciful eventide for the unfortunate gentleman who henceforth will experience much freedom and little responsibility in the realm of strenuous, working-day finance.

1. A dividend, forsooth!

Amend the Bank Act.

Copy of article which appeared in the *Mail and Empire* of February 4, 1907 :

The sentence received by Charles McGill punishes him and may deter others in a like position of trust from committing a like crime. But it can in no way compensate the shareholders of the Ontario Bank. To them a little timely prevention on the part of the law would have been worth a thousand times more than its penalties for the accomplished crime. The offence for which the ex-general manager of the Ontario Bank is now to serve five years in the penitentiary was not one nipped in the bud while its effects were yet comparatively harmless, but it was one found out only after the ruin of the bank had been completed. The wrecking process was not the work of a day or a week, or of any short period, but it will probably be found to have been continued over a series of years. No long protracted operations of dishonesty could have been possible had the law provided independent tests and automatic checks such as are employed in British banking. An independent audit would have exposed the first departure from the path of rectitude. Had there been such an audit the general manager would have been stopped early in his course of wrongdoing, and would doubtless have been removed before he could have greatly impaired the bank's resources. As it was, his dishonesty worked on insidiously until the bank's paid-up capital and its rest were all but wasted away. To say that the lack of an auditor serves to sharpen the vigilance of shareholders is really to admit the importance of the auditor's functions. If keen watchfulness on the part of shareholders is of prime necessity, then why not systematize that watchfulness in the form of an audit service? It is as the representative of the shareholders directly and of the general public indirectly that an auditor would carry on his enquiries. His activity would be serviceable to depositors and noteholders as well as to shareholders. With the right kind of auditing the very beginning of evil in the Ontario Bank would have been detected, and we should not have had to wait until the capital is gone and a really great crime has to be punished. The enquiry into the wrecking of the Ontario Bank has gone far enough to indicate very clearly to the Government the points for immediate amendment in the Bank Act. In the first place, the Finance Minister should have some means of verifying statements sent in by bank officials. That is, there should be Government inspection. In the second place, there ought to be an independent audit. At a time when our banks are increasing in number and still more rapidly increasing in the aggregate of their capital, it is in the highest degree important that the weaknesses which have been laid bare in the Ontario Bank case should at once receive the attention of Parliament.

Extract from report of Grand Jury at Assizes in Toronto, February, 1907, *Evening Telegram*, February 5, 1907:

Referring to the case of Charles McGill and the Ontario Bank, we are of the opinion that it is the duty of the Government to at once establish some system of inspection of our banking and other monetary institutions that will safeguard the investing public from deceitful and fraudulent statements issued by Boards of Directors, who, apparently, in this instance, have been grossly negligent of their duty as trustees for the shareholders of the bank.

The following suggestions for amendment to the Bank Act were presented to the Annual Meeting of the Canadian Bankers' Association, 25th November, 1909, and received no support:

1. The Association shall appoint a Board of Auditors, hereinafter called the Board. The Board so appointed shall make an annual examination of each bank and, if such examination is satisfactory, shall through the Chairman of the Board cause to be certified the annual statement issued by the bank to its shareholders. This certification shall state that, in the judgment of the Auditors, the statement is a fair statement and conservative representation of the bank's affairs. No statement or balance sheet shall be issued without such certificate.

2. The Board shall consist of not less than seven full members, of whom four shall form a quorum, and of not less than seven associate members, all of whom shall be elected by vote of the General Managers of all the banks, and one-tenth of such vote being recorded against a candidate for either full or associate membership shall exclude him from election. The Chairman of the Board shall be appointed from the members of the Board by a vote of the General Managers of the banks.

3. Save as hereinafter provided, no candidate shall be eligible for election as a full member of the Board unless he has had five years' previous experience in bank auditing, but a candidate having a less experience may be elected a full member of the Board by the unanimous vote of the General Managers. After five years' experience in bank auditing an associate member may be elected a full member by the vote of the General Managers.

4. No candidate shall be eligible for election, either as a full or as an associate member of the Board, unless he is a member of the Canadian Board of Chartered Accountants, or of the Ontario Board of Chartered Accountants, or of the Institute of Chartered Accountants for England and Wales, or the Scottish Chartered Accountants, or of such other body of auditors or accountants as may be approved by the Association.

5. No Director or Officer of any bank shall be capable of being appointed on the Board.

6. Any member or associate of the Board may at any time be removed therefrom, with or without cause shown, by a majority vote of the General Managers of all the banks.

7. The executive of the Association shall annually appoint for each bank, from the Board, an auditor or auditors, of whom at least one shall be a full member. But in no case shall a member, who has been elected to the Board notwithstanding opposition, be eligible to audit the accounts of the bank or banks whose General Manager has opposed his election.

8. The auditor or auditors so appointed shall, for that year, audit the accounts of the bank particularly and carefully with reference to the annual statement issued by the bank to the shareholders. The auditors shall, for that purpose, make an examination of the Head Office of the bank, and shall examine any of the branches if such examination shall seem to them to be desirable.

9. Every auditor of a bank shall, for the purpose of such audit, have the right of access, at all times, to the books, accounts and vouchers of the bank, and shall be entitled to require from the directors and officers of the bank such information and explanation as may be necessary for the performance of the duties of the auditors.

10. The auditors shall make a report to the Chairman of the Board on the accounts examined by them, and on every annual statement and balance sheet proposed to be laid before the shareholders of the bank in general meeting during their tenure of office, and the report shall state :

(*a*) Whether in their judgment the inspection of the branches is regularly and efficiently performed by the bank's regular inspectors.

(*b*) Whether the general supervision of the loans and investments appears to be thorough.

(*c*) Whether they have obtained all the information and explanations they have required.

(*d*) Whether in their opinion the balance sheet referred to in the report is properly drawn up so as to exhibit a fair and conservative view of the state of the bank's affairs.

11. Such report shall be in writing and shall be signed by the auditors aforesaid in duplicate. Both duplicates shall be delivered to the Chairman of the Board. One duplicate shall be fyled by him and the other shall be delivered by the Chairman to the directors of the bank. The Chairman of the Board shall not permit inspection of the duplicate fyled with him by any person except the General Manager of the bank interested, unless as hereinafter provided.

12. If the auditors' report is satisfactory, the Chairman of the Board shall certify the statement of the bank.

13. In case the examining auditors decline to certify the statement of a bank, the report of the auditors shall be considered by the Board without delay, and the Directors and General Manager of the bank may appear before the

Board. Should the Board affirm the action of the examining auditors, the facts shall be at once reported to the Executive Committee of the Association, and through the Association to the Minister of Finance. Thereupon, a direction may be made by the Executive of the Association, with the concurrence of the Minister of Finance, if, in their opinion, it is right and proper so to do, that the Chairman of the Board do certify such statement, and the Chairman of the Board shall accordingly certify the statement; or a direction may be made that the bank do alter its statement to accord with the judgment of the Board.

14. Every person appointed to the Board of Auditors shall, before assuming his position on the Board, subscribe and make a statutory declaration in the words following:

"I will not at any time discuss or divulge to any person, save in accordance with the provisions of the Bank "Act, any information which I may acquire directly or "indirectly regarding any chartered bank of Canada, or "any of its affairs, or the affairs of its clients, whether "such information is acquired by me as a member of the "Board of Auditors of the Bankers' Association or otherwise."

15. The appointment of members and associates to the Board of Auditors shall be made at a meeting of the Association. In case any General Manager is not present at such meeting he shall nevertheless have the right to vote on the question of such appointment, and may do so by letter despatched to the Secretary of the Association within one week after notice of such proposed appointment has been received at the Head Office of the bank, in default of which his vote shall be recorded as in favor of the candidate.

16. In case the Association fails to appoint a Board of Auditors, as herein provided, within six months from the passing of this Act, it shall be the duty of the Minister of Finance forthwith to appoint such Board.